

IT 01-1

Tax Type: Income Tax

Issue: Insurance Company Issues

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**ABC MUTUAL LIFE
INSURANCE COMPANY,
TAXPAYER**

**NO: 99 IT 0000
FEIN: 00-0000000
TAX YRS: 1993-1995**

**Kenneth Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Ms. Tracy Williams and Ms. Mary Kay McCalla Martire on behalf of ABC Mutual Life Insurance Company; Mr. David Dorner, on behalf of the Illinois Department of Revenue.

SYNOPSIS:

This matter comes on for hearing pursuant to ABC Mutual Life Insurance Company's (hereinafter "ABC" or "taxpayer") timely protest of a Notice of Denial issued by the Illinois Department of Revenue (hereinafter "DOR" or "Department") on September 13, 1999, denying ABC's claims for refunds for tax years 1993 through 1995. The Department denied the claims because it was unable to determine the amount of "Life and Health Insurance Guaranteed Association" offsets that ABC was entitled to under the Illinois Insurance Code. An evidentiary hearing was held in this matter on October 5, 2000, with Mr. John Doe, vice-president and director of corporate tax for ABC, testifying. The parties submitted a "Joint Stipulation of Documents"

(hereinafter “Joint Stip.”) at the hearing. Following the submission of all evidence and a review of the record, it is recommended that the Notice of Denial be cancelled.

FINDINGS OF FACT:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, was established by the Notice of Denial issued on September 13, 1999, denying ABC’s claim for a refund for overpayment of income taxes in the amount of \$12,050 for 1993, \$39,997 for 1994 and \$88,206 for 1995. Tr. pp. 17-18; Dept. Ex. Nos. 1, 2.
2. In 1993, 1994 and 1995, ABC Mutual Life Insurance Company was known as Century Life of America, and its tax returns were filed under that name. Tr. pp. 27-28.
3. ABC is a foreign insurance company doing business in Illinois and is required to pay Illinois Privilege Tax (215 ILCS 5/409) to the Illinois Department of Insurance (“DOI”). During 1993-1995, the tax was calculated at 2% of premiums. ABC was also responsible for the Illinois Income Tax imposed by 35 ILCS 5/201(a) and (b). Tr. pp. 30-31; Taxpayer’s Brief, p. 2.
4. ABC was required to be a member of the Illinois Life and Health Insurance Guarantee Association (the “Association”) as a condition of doing business in Illinois. (215 ILCS 5/531.06) The Association protects policyholders from the failure of their life or health insurance companies by assuming certain obligations of an insolvent insurer. The Association funds its activities by assessing its member companies. (215 ILCS 5/531.09) Tr. p. 31; Taxpayer’s Brief, p. 3.
5. When the Association’s assessments exceed \$3,000,000 in any calendar year, the excess over \$3,000,000 may be used as a tax offset. 215 ILCS 5/531.13 states that “each member insurer may offset the proportionate amount of such excess paid by the insurer against its liabilities for

the tax imposed by subsections (a) and (b) of Section 201 of the Illinois Income Tax Act, for the tax imposed by Section 409 of the “Illinois Insurance Code” [the Illinois Privilege Tax], and for the fees imposed by Section 408.1 of the “Illinois Insurance Code.” The offset against the fees imposed by Section 408.1 is not relevant in this matter. Tr. pp. 31-33.

6. For tax year 1993, ABC was advised by the Association that it was entitled to an offset of \$17,199. ABC adjusted this amount for certain allowable credits used in prior tax years. The adjusted offset was \$12,050. Tr. pp. 34-35; Joint Stip. No. 4.
7. For tax year 1994 and 1995, ABC was advised by the Association that it was entitled to offsets of \$77,830 and \$88,206, respectively. No adjustments were made to these offsets. Tr. pp. 35-36; Joint Stip. Nos. 10, 15.
8. In 1993, ABC’s Illinois Privilege Tax was \$176,220. ABC had available credits and offsets of \$264,359 including the Association offset of \$12,050. ABC listed the entire \$12,050 as an offset on line 13(c) of the “Privilege Tax Statement.” ABC’s “Net Privilege Tax,” (tax less offsets) was zero. When ABC filed its original “IL-1120, Corporation Income and Replacement Tax Return” for 1993, it did not list the \$12,050 as a credit. Tr. pp. 37-38, 42; Joint Stip. Nos. 1, 2, 5.
9. In 1994, ABC’s privilege tax was \$149,161. ABC had available credits and offsets of \$189,158 including the Association offset of \$77,830. ABC listed the entire \$77,830 as an offset on line 13(c) of the “Privilege Tax Statement,” although only \$37,833 of the offset was necessary to bring the “Net Privilege Tax” to zero. When ABC filed its original “IL-1120,” for 1994, it did not list the available portion of the offset, \$39,997, (\$77,830 less \$37,833) as a credit. Tr. pp. 38-38, 43; Joint Stip. Nos. 7, 11.

10. In 1995, ABC's privilege tax was \$133,364. ABC had available credits and offsets of \$233,986 including the Association offset of \$88,206. ABC listed the entire \$88,206 as an offset on line 13(c) of the "Privilege Tax Statement." ABC's "Net Privilege Tax" was zero. When ABC filed its original "IL-1120," for 1995, it did not list the \$88,206 as a credit. Tr. pp. 39-40, 43; Joint Stip. Nos. 8, 13, 16.
11. On October 13, 1997, ABC filed an "IL-1120-X" for 1993, showing \$12,050 as an income tax credit on line 11(a). The credit was notated "LHGA" for "Life and Health Guaranty Association." This credit resulted in an overpayment of taxes and a claim for a refund of \$12,050. Tr. pp. 52-53; Joint Stip. No. 3.
12. On October 13, 1997, ABC filed an "IL-1120-X" for 1994, showing \$39,997 as an income tax credit on line 11(a). This amount represented the available portion of the 1994 Association offset. The credit was notated "LHGA." This credit resulted in an overpayment of taxes and a claim for a refund of \$39,997. Tr. pp. 54-57; Joint Stip. No. 9.
13. On October 13, 1997, ABC filed an "IL-1120-X" for 1995 showing \$88,206 as an income tax credit on line 11(a). The credit was notated "LHGA." This credit resulted in an overpayment of taxes and a claim for refund of \$88,206. Tr. pp. 57-59; Joint Stip. No. 14.
14. On January 22, 1999, ABC received a letter from the DOR stating that "IL-1120-X's" for 1993 through 1995, filed in 1997, had been received and were being "forwarded to the Notice Section for issuance of a Notice of Claim Denial." "After contacting the Illinois Department of Insurance in December, 1998, it was determined that they are unable to verify the amount of credit which you filed on your IL-1120-X's for the period 12/93 through 12/95. These claims are in the process of being denied until the legal action with the Illinois Department of Insurance is completed." Tr. pp. 61-67; Taxpayer's Ex. No. 22.

15. On September 13, 1999, the DOR issued a Notice of Denial to ABC. The notice stated as follows: "The Department is unable to determine the amount of Life and Health Insurance Guaranteed Association offsets entitled under Section 531.13 of the Illinois Insurance Code. This information must be recalculated and provided by the Illinois Department of Insurance." Tr. pp. 82-83; Joint Stip. No. 18.

CONCLUSIONS OF LAW:

ABC is a foreign insurance company doing business in Illinois and is required to pay Illinois Privilege Tax (215 ILCS 5/409) to the DOI and Illinois Income Tax (35 ILCS 5/201) to the DOR. ABC can use the income tax paid as a credit to the privilege tax. ABC is also required, as a condition of doing business in Illinois, to be a member of the Illinois Life and Health Insurance Guarantee Association. 215 ILCS 5/531.06. The Association funds its activities by assessing its member companies. 215 ILCS 5/531.09. When the assessment exceeds \$3,000,000 in any calendar year, the excess may be used as a credit to either the Illinois Income Tax or the Illinois Privilege Tax. 215 ILCS 5/531.13.

The "Privilege Tax Statements" filed by ABC for the years at issue contain the following relevant lines:

- 12. Illinois Privilege Tax.
- 13(c). Less: Allowable Life Guaranty Fund offset per the Association's report.
- 13(d). Less: Policy Form filing fees paid per [tax year].
- 13(e). Less: Financial Regulation Fee paid in [tax year].
- 14. Less: Illinois State Corporate tax paid per Schedule C, page 3.
- 16. Net Privilege Tax.

When ABC filed its original "Privilege Tax Statements" with the DOI for 1993 and 1995, it listed Illinois Privilege Taxes on line 12 of \$176,220 and \$133,364, respectively, and total credits on line 13(c)(d)(e) and line 14 of \$264,359 and \$233,986, respectively. These credits included the

Association offsets of \$12,050 and \$88,206 respectively on line 13(c). In both years, the Net Privilege Tax was zero. The offsets listed on line 13(c) were extraneous to the determination of the Net Privilege Tax in both years because the Net Privilege Tax would still have been zero even if the offsets had been omitted from the statements. Although ABC was entitled by 215 ILCS 5/531.13 to use the Association offsets as a credit to either the income tax or the privilege tax, the extraneous offsets were not listed as credits on the original “IL-1120’s” filed by ABC with the DOR for 1993 and 1995.

When ABC filed its original “Privilege Tax Statement” with the DOI for 1994, it showed Illinois Privilege Tax on line 12 of \$149,161, and total credits from line 13(c)(d)(e) and line 14 of \$189,158. These credits included the entire Association offset of \$77,830 on line 13(c), but only \$37,833 of the offset was required to bring the Net Privilege Tax to zero. \$39,997 of the \$77,830 offset was extraneous to the determination of the Net Privilege Tax and the Net Privilege Tax would have still been zero even if the \$39,997 had been omitted from the statement. The \$39,997 was not listed as a credit to the Illinois Income Tax on the original “IL-1120” filed by ABC with the DOR for 1994.

Mr. Doe testified at the evidentiary hearing that when ABC realized that the extraneous credits were listed on the “Privilege Tax Statements” for 1993 through 1995, it filed amended statements with the DOI. Doe testified that in each of the amended “Privilege Tax Statements,” the only change was the dollar amount on line 13(c). In 1993 and 1995, line 13(c) was reduced to zero and in 1994, it was changed from \$77,830 to \$37,833. Doe stated further that in all amended statements, line 12, “Illinois Privilege Tax” remained the same and line 16, “Net Privilege Tax” remained at zero. ABC then filed amended Illinois income tax returns and used the extraneous credits as offsets to its income tax. This resulted in an overpayment of income taxes with ABC

requesting a refund from the DOR of \$12,050, \$39,997, and \$88,206 for 1993 through 1995 respectively. The DOR denied these refunds as detailed in the Notice of Denial issued on September 13, 1999.

The DOR advances several arguments for denying ABC's refunds. The DOR first argues that the refunds should be denied because "the most important thing is there is no evidence that the amended privilege tax statements [filed] with the Department of Insurance have been accepted or allowed." Tr. p. 102. "Had the amended return[s] in this case been accepted by the Department of Insurance and we had in evidence that [they] had been accepted, then the Department [of Revenue] would have processed these returns and should have processed these returns." Tr. p. 100.

I conclude, based on the testimony and evidence presented at the hearing, that the issue in this case is not whether the DOI accepted or allowed the amended returns, but whether ABC advised the DOI that the returns were being amended. The Association offsets at issue were extraneous to the calculation of the Net Privilege Tax on the original returns filed with the DOI. Accordingly, if amended returns were filed with the DOI, they would have been merely informational. Since the Illinois Privilege Tax amount (line 12) and the Net Privilege Tax amount (line 16) did not change for any of the three years, there was, in effect, nothing for DOI to "accept" or "process." If ABC advised the DOI that the privilege tax returns were being amended, there was no statutory provision which would prevent ABC from using the offsets as credits against the Illinois Income Tax on amended statements filed with the DOR.

I also conclude, based on the testimony and evidence admitted at the hearing, that ABC did in fact send amended privilege tax returns to the DOI. ABC's evidence included a letter dated October 9, 1997, addressed to the "Illinois Department of Insurance," "Tax and Fiscal Services Section." The letter states that Illinois Privilege Tax returns for the years at issue are enclosed.

“The only change on the amended returns is the reduction of the Allowable Life Guaranty Fund offset on Page 4, line 13(c).” Taxpayer’s Ex. No. 20. The amended returns show that, for 1993 and 1995, ABC eliminated the Association offset on line 13(c). For 1994, ABC reduced the Association offset on line 13(c) from \$77,830 to \$37,833. The “Net Privilege Tax” for all three years remained zero. Tr. pp. 45-48, 53-60; Joint Stip. Nos. 6, 12, 17. Mr. Doe testified that all tax payments and returns were sent by certified mail. Tr. p. 46.

ABC’s evidence also includes a page from “a document prescribed by the U.S. Post Office that large volume taxpayers or large volume certified mail users can use to list article numbers, shippers and the various services that [they] request of the post office.” Tr. pp. 46-47. This document shows an article being sent to “The Illinois Dept. Of Insurance,” “Tax & Fiscal Services Sec.” The page was stamped by the U.S. Post Office on October 15, 1997. Taxpayer’s Ex. No. 21. These exhibits were admitted without objection by the Department. Tr. p. 89. Furthermore, the Department admits that amended privilege tax statements had been sent: “In addition, although the Taxpayer prepared and mailed amended Statements to the DOI, there is absolutely no evidence that the amended Statements have been received or accepted by the DOI.” Department’s Brief, p. 8. Based on the testimony and documentary evidence admitted at the hearing, I conclude that ABC mailed amended privilege tax statements to the DOI, and the offsets could then be used as credits to the Illinois Income Tax.

The Department also argues that “amended statements are only allowed if it appears to the satisfaction of the Director of DOI that the amended statement was filed due to some mistake of fact, error in calculation, or erroneous interpretation of a statute of this or any other state.” Department’s Brief, p. 13. In support of this argument, the Department cites 215 ILCS 5/412 which states:

Whenever it appears to the satisfaction of the Director that because of some mistake of fact, error in calculation, or erroneous interpretation of a statute of this or any other state, any authorized company has paid to him pursuant to any provision of law, taxes, fees or other charges in excess of the amount legally chargeable against it, during the six year period immediately preceding the discovery of such overpayment, he shall have the power to refund to such company...

This statute in the Illinois Insurance Code is entitled “Refunds; Penalties; Collection” and is obviously directed to situations where an insurer/taxpayer is requesting a refund from the DOI for the overpayment of privilege taxes. In those circumstances, it must appear “to the satisfaction of the Director” that the refund is justified because of some mistake of fact, error in calculation or erroneous interpretation of a statute. The amended returns filed by ABC were informational only and no refund was requested. I am unable to conclude from the above statute that ABC’s amended returns must “appear to the satisfaction of the Director” to be similarly justified. ABC and the Department have not suggested, and my own research does not indicate, that there is any DOI statute governing amended informational returns when no refund is requested.

The Department argues further that there is nothing in the statutes, case law or regulations which would suggest that the DOI will ignore line 13(c) [the Association offset] in situations where other credits listed on the Privilege Tax Statements are greater than the privilege tax.” Department’s Brief, p. 11. The Department argues that the privilege tax form “suggests” that the lines are subtracted in the order in which they are listed. “Nowhere does it state... that the DOI will skip line 13(c) if the subsequent lines are greater than line 12, the privilege tax.” Department’s Brief, p. 13. According to the Department, if the DOI subtracted the credits to the privilege tax in the order that they were written on the form, any “extraneous” credits would come from line 14, rather than from line 13(c).

The Department's argument ignores the fact that Section 531.13 of the Illinois Insurance Code states that each member insurer may offset the proportionate amount of [its Association assessments] against its liabilities for the tax imposed by subsection (a) and (b) of Section 201 of the Illinois Income Tax Act, for the tax imposed by Section 409 of the Illinois Insurance Code, and for the fees imposed by Section 408.1 of the Illinois Insurance Code. 215 ILCS 5/531.13. Section 531.13 does not require that the Association offsets be used in any particular order with other available credits or listed in any particular order, or that the Association offsets, once listed, must be applied by DOI in any particular order. Nor does the statute indicate that an insurer/taxpayer makes an irrevocable election simply by listing the offset on an Illinois Privilege Tax return. For comparison purposes, it is noted that 35 ILCS 5/207 of the Illinois Income Tax Act allows net loss carrybacks "in the manner allowed under Section 172 of the Internal Revenue Code." Section 172 states that a carryback can be waived in favor of a carryforward, and that "such election, once made for any taxable year, shall be irrevocable for such taxable year." I.R.C. § 172 (b)(3). At the evidentiary hearing, ABC characterized the listing of the Association offsets on the original privilege tax returns as a "clerical oversight." Tr. p. 41. There is no Illinois statute requiring that this "oversight" would constitute an irrevocable election. The Department's final argument centers on documents sent by the Department to ABC during discovery. On July 2, 2000, the Department sent ABC an "Audit Comment," dated January 22, 1999, in which the auditor wrote that "Century Life was a party of a protest act case dealing with the privilege tax. This case was won by the taxpayers. As a result of this case, the Department of Insurance will recalculate the Taxpayer's liability on their Privilege/Retaliatory tax return." On January 22, 1999, the Department sent ABC a letter saying that the Department had received ABC's IL-1120-X's for 1993 through 1995 and that a notice of claim denial was being issued. The letter states: "These

claims are in the process of being denied until the legal action with the Illinois Department of Insurance is completed.” Taxpayer’s Ex. No. 22. The auditor was not called to testify at the evidentiary hearing and the “Audit Comment” and Department letter to ABC do not indicate specifically what “legal action” ABC was supposedly involved in.

At the evidentiary hearing, Mr. Doe testified that ABC was not involved in any tax litigation with the DOI. Tr. pp. 80-82. ABC’s evidence includes a partial pleading containing a listing of thirty three plaintiffs involved in litigation with the DOI and a signed order from Judge Alexander P. White, dated May 27, 1998, finding that “the privilege tax imposed by Section 409 of the Illinois Insurance Code (215 ILCS 5/409) is unconstitutional.” The thirty-three plaintiffs include “XYZ Insurance Society, Inc.” and “ABC Mutual Insurance Society.” Taxpayer’s Ex. No. 23.

ABC states in its Brief that “ABC is not related to ABC Mutual Insurance Society or XYZ Insurance Society by ownership, and ABC’s unitary Illinois income tax returns do not include ABC Mutual Insurance Society or XYZ Insurance Society.” According to ABC, the auditor was “mistakenly informed that ABC was part of the protest act case.” Taxpayer’s Brief, pp. 8-9. The Department argues that it would be speculation to infer that the “protest act case” referenced in the “Audit Comment” served as the sole basis for the Notice of Denial and it would also be speculation to infer that ABC’s partial pleading was the same case referred to by the auditor. Department’s Brief, p. 16. No evidence was offered by the Department to rebut ABC’s statement that it had never been involved in any litigation with DOI, or that ABC was not included in the group of plaintiffs who sued the DOI in the above lawsuit.

Pursuant to Illinois statute, the Notice of Denial is *prima facie* correct and serves as the basis for the denial of ABC’s refund claims. 35 ILCS 5/904. ABC argues that the Notice of Denial

was issued on mistaken information, namely that ABC was involved in litigation with the DOI. Taxpayer's Brief, pp. 8-9. ABC's right to the Association offsets for use as credits to either its Illinois Income Tax or Privilege Tax is established by statute, and is not dependent on whether ABC is involved in litigation with the DOI. ABC has produced competent evidence identified with its books and records showing that the Department incorrectly denied the refunds. Taxpayers bear the burden of proof to show that they are entitled to claim a credit against its income taxes. Balla v. Department of Revenue, 96 Ill. App. 3d 293 (1st Dist. 1991). I conclude that the Department has failed to present any reasonable basis for the denial of ABC's claim for refund. ABC satisfied its burden by refuting each of the arguments advanced by the Department.

For these reasons, it is my recommendation that the Notice of Denial be cancelled.

ENTER:

Date: January 5, 2001

Kenneth Galvin
Administrative Law Judge